Ontario Economic Council
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NOT FOR RELEASE BEFORE MARCH 28, 1984

NEWS RELEASE #2: PENSIONS TODAY AND TOMORROW
BACKGROUND STUDIES

ALTERNATIVE POINT OF VIEW

TORONTO ... A study by the Ontario Economic Council provides fresh insight into The Great Canadian Pension Debate. It offers a collection of perspectives, a variety which can assist both policy-makers and the general public who are looking for background information on the issues of pension and pension reform.

- The experience of other countries.
- The federal-provincial bargaining process.
- Who will pay for pension reform?
- Impact of reforms on the capital market.
- Inflation and pension indexation.
- Registered pension accounts.
- Impact of pension reform on women.
- Views of the labour movement.
- Individual freedom and pensions.
- Future demographic trends.

Don Lee of Union Pension Services Ltd., Toronto, examines pension data in eight countries, and then considers more thoroughly the historical experience of Sweden, the United Kingdom, and the United States compared with that of Canada. He concludes that:

'The experience of other countries suggests two fundamental conclusions about the prospects for pension reform in Canada: private coverage will not expand beyond existing levels without state intervention; and the scope of public programs will have to grow in

response to the aging of our population...The main issue is not whether the primary responsibility for delivering retirement income should fall on public programs or private initiative. It will fall on public programs. The more substantial issue is, 'On what basis should the majority of Canadians become entitled to adequate public pensions?' If we resolve to implement a public system which delivers earned rights for the majority, we can then approach on a constructive basis the supplementary question, 'What framework of regulation will secure a continuing role for private plans?'

Professor Keith Banting, Department of Political Science, University of British Columbia, emphasizes that 'the decision rules which govern any reform process are critical to the kinds of decisions which emerge from it... the key decision rules...are those implicit in our federal system'. Consequently, we must focus on the federal-provincial bargaining process if we wish to understand the likely path of reform. Here a key element is what Banting refers to as 'a system of multiple-veto points', in which either the federal government or various combinations of provinces have the right to block CPP/QPP changes. This he sees as a conservative force, delaying reform.

Banting notes that Quebec governments have traditionally wanted public sector expansion. Ontario governments, on the other hand, have persistently supported policies encouraging private sector plans, and have felt that the 'CPP should not be a tool of income redistribution'. Meanwhile, the federal government's history of expansionist welfare programs' incline it instinctively towards a public sector response to pension needs'.

Professor Charles Beach, Department of Economics, Queen's University, Kingston, Ontario, examines the question 'Who will pay for proposed public pension reforms?' He focuses on CPP/QPP contributions and he notes that these are a type of payroll tax. Beach considers the effects of four levels of such tax: 9 per cent, 12 per cent, 15 per cent, and 20 per cent, with each tax level divided evenly between employers and employees. The major

thrust of this paper is that the legal tax rate is not the same as the effective tax rate. Firms may shift their tax forward onto consumers through higher prices or backwards onto employees through lower wages. Similarly, employees may be able to shift some of their tax burden, and the number of jobs may fall. Beach calculates the impact of each tax level on the number of jobs and also on the after-tax earnings of several different groups: young men, older men, young women, and older women. Differences in the labour markets for each of these mean that some workers have to absorb more of the tax personally than do others, while some groups suffer more job losses than do others as a result of the higher employee costs faced by employers. Increases in CPP/QPP contribution rates will not affect all workers or firms equally.

C. Ross Healy, President of Standard Capital Management Corporation, Toronto, discusses the likely impact of pension reform proposals on the capital market. He emphasizes the importance of maintaining a strong, private capital market, and warns that some reforms could shift huge funds into government hands. This could diminish the growth of private firms and could result in unwise government investments. Healy stresses that 'within 17 years, it (pension funds) will likely be the dominant capital pool and main repository of ownership in Canada'. Consequently, a fundamental issue is whether these funds will be invested by the private sector or by governments.

Professor Greg Jump, Department of Economics, University of Toronto, refers to publications of other economists and then develops his own analysis in order to predict the impact on capital markets of various types of pension funding. In particular, the decision as to how much we should fund our public pension plans - fully, partially, or not at all - may affect people's incentive to save, our nation's volume of investment, and, consequently, our capital stock.

Jump suggests a novel proposal, that private employers be allowed to invest CPP funds, so as to maintain the advantage of decentralized non-governmental investment decisions.

Professor John Bossons, Institute for Policy Analysis, University of Toronto, discusses 'Indexed bonds as a instrument of pension reform'. He stresses the impact of inflation on the real value of pensions, noting that over the past twenty years, 1963-83, a fixed, nominal pension would have experienced a 72 per cent decline in real value. Bossons discusses the benefits to be derived from pension indexation, the ability of indexed-debt instruments to lower the costs of providing indexed pensions, and, finally the feasibility of creating markets in indexed bonds for this purpose. He suggests that 'without markets in indexed bonds, the costs of requiring private pensions to be indexed are probably unacceptably high'.

Dr. Ken Marchant of Capital Cities Consultants Ltd., Toronto, has analysed 'Registered Pension Accounts (RPAs) as an instrument of pension reform'. Under the Green Paper's proposals, the RPA would be a new type of pension fund similar in some ways to the current RRSP. Contributions and investment earnings would avoid taxation until ultimately received in the form of a pension. A key difference from the RRSP is that employers could contribute to it. Hence, with the RPA, employer contributions could be portable, and to facilitate portability - vesting could occur earlier than at present.

An important Green Paper proposal, however, would lock all contributions into the RPA until retirement, as opposed to current practice under which RRSP funds can be withdrawn, subject to income tax, at any time. Marchant is critical of another Green Paper proposal, that every individual be restricted to one RPA. This would constitute a basic change from current RRSP provisions, under which an individual can have as many RRSP's as he or she chooses. He discusses whether many small businesses and self-employed who currently do not have pension plans would adopt

the RPA concept. Marchant suggests several improvements in the Green Paper's proposals, including lifetime contribution limits rather than annual limits, the right to invest in foreign currencies, and the opportunity to have more than one RPA per person.

Professor Douglas Purvis, Department of Economics, Queen's University, Kingston, Ontario, considers several broad, basic questions: 'why do we have (or need) pensions? Who actually pays for them? What type of commitment should the pension entail?' He emphasizes the uncertainty surrounding pension arrangements when inflation can reduce their real value. He points out that even steps taken to index pensions may not provide certainty since a future generation may decide 'to renege on its commitment and rewrite public pensions to call for a lower real income stream'.

Three authors have concentrated on the impact of pensions and pension reforms on women: Monica Townson, Marie Corbett, and Terry Bisset. Townson, an Ottawa consultant, notes that 'many people involved in the pensions debate have a rather limited view of pension reform for women', restricting their analysis to homemakers and surviving spouses. She emphasizes that the traditional family 'has already passed into history'. The majority of Canadian women are in the work force, and so - apart from the primary issue of more assistance for the current elderly - Townson stresses the current poor pension coverage for working women. In dealing with various reform proposals, she presents 'the general conclusion that if we don't want the majority of Canadian women to end up poor, as they do now, then pension reform cannot be based on old myths and stereotypes. It must address the new reality of women's lives'.

Marie Corbett, a Toronto solicitor, examines employment pension plans from the perspective of women: 'While not discriminatory in themselves, employment pension plans (RPPs) are not an effective source of retirement income for women and will continue to be ineffective unless changed...First... women work predominantly in areas of low coverage...Second, since the amount of employment-

pension income is directly related to earnings, the lower earnings of women result in lower pension income... Third... The requirement for long and continuous service in order to obtain a pension has a devastating effect on women because of the nature of their work patterns.'

Consequently, the most important reforms would be to improve pension rights on termination of employment and to provide more thorough pension coverage for part-time workers. Corbett also urges that sex-differentiated benefits should be removed from all annuities.

Terry Bisset, a Policy Analyst, Ontario Women's Directorate, Toronto, analyses the impact of divorce arrangements on pension rights. She notes that 'a rising divorce rate is a present-day reality', and, consequently, pension regulations should be formulated with divorce in mind. 'It appears that a strong case can be made for pensions to be seen as assets and therefore divisible upon marriage breakdown. If that is so, then the pivotal question becomes how to undertake this division'.

Three authors discuss the optimal balance between public and private pensions and the optimal path for the implementation of reform: Clifford Pilkey, Donald Coxe, and Richard Wietfeldt.

In his paper, 'Public versus private pensions', Pilkey, the President of the Ontario Federation of Labour, presents the views of the labour movement. He indicates a basic dissatisfaction with some private plans: 'Many pensioners have come to the conclusion that the wages sacrificed to pay for a company plan do not produce the retirement security which they have a right to expect in return'. Recognizing that our current prosperity grows out of the labour of previous generations, 'all public pensions should increase automatically with improvements in our standard of living'. Pilkey discusses the limitations of private plans, such as the requirements for funding and the risk that inflation adjustment will not be made

if the employer goes out of business. Consequently, he expresses the opinion that 'There are no satisfactory solutions to the problems of coverage and indexation within the framework of the private system'. Pilkey then presents specific recommendations to improve the public system, including increasing maximum benefit levels from 25 per cent to 50 per cent of pensionable earnings; increasing Old Age Seucirty (OAS) to 20 per cent of the average industrial wage; and raising the Guaranteed Income Supplement (GIS).

Donald Coxe, Vice-President, Gordon Securities Ltd., Toronto, suggests a different view: 'We know that, with all its faults, the current mix delivers adequate incomes to all but a high percentage of the single elderly, who are mostly female. By isolating this target group for immediate action, we can, if we have the will, solve our current problems'. Referring to predictions of an impending funding crisis, Coxe argues that Hamilton and Whalley underestimated the problem because they did not include the cost of free drugs for the elderly or the cost of public-sector employee pension plans. The latter in particular, will prove difficult since 'Most of the biggest are either underfunded or not funded at all... By 2020, the annual cost burden of these monsters may make the CPP look like a modest nuisance'. Coxe warns against a doubling of the CPP because of the cost entailed. Yet he does recommend inflation protection, earlier vesting, improved portability, and more thorough disclosure to plan members of pension-fund investments.

Richard Wietfeldt, Research Director, Canadian Federation of Independent Business, Toronto, claims that 'the gaps in our present retirement-income structures are relatively manageable'. Consequently, he feels, basic structural changes are not desirable.

While accepting the 'role of the state to assure at least a floor retirement income', Wietfeldt argues that pensions should not be structured to redistribute income beyond that purpose. Furthermore, Wietfeldt argues for individual freedom to establish one's own saving and investment decisions and that the Green Paper's

emphasis on expanding the role of government is not justified. 'It is our view that until we find a good argument for further paternalism in regard to retirement income, we should leave well enough alone'.

Leroy Stone, of the Population Studies Centre, University of Western Ontario in London, and Susan Fletcher, with the Office on Aging, Health and Welfare Canada, examine demographic forecasts and explain 'Why we should be cautious in accepting forecasts of the dependency ratios in the 21st century'. In particular, they criticize the pessimistic projections of Hamilton and Whalley who 'based suggestions about the economic implications of future demographic trends on too narrow a range of possible demographic futures... More time needs to be spent studying implications of the wider range of alternative futures'.

Stone and Fletcher point to the possibility of significant changes in mortality rates; and they note the importance of birth rates in determining the total number of society's dependents and the proportion of the population contributing to the retirement-income pools.

They also note that future international migration may alter current projections. Overall, Stone and Fletcher introduce a serious warning that demographic surprises may occur and that key elements in pension reform will be flexibility and innovation in order to deal with such changes if they arise.

'The coverage question in the pension debate' provides an analysis by D.S. Rudd of the extent to which people make use of private sector plans. Rudd is responding to those who criticize the coverage of private plans.

He pays particular attention to those in the higher-earnings groups where private pension coverage becomes more important to maintain a comparable standard of living after retirement. Rudd concludes that: 'The studies indicate that private pension

coverage is in the area of 65 to 70 per cent for those earnings one-half of the Average Industrial Wage or more and who are in the age range of 25 to 64. If we look at this age range for those earnings the AIW and up, coverage is in the range of 75 to 80 per cent.

Furthermore, all the studies indicate that coverage ratios increase with attained age as well as with income. This is less pronounced for females, as many leave the labour force or are in part-time employment.

Most of the problems concerning female coverage are due to the disproportionate numbers of women in the labour force at young ages and with lower incomes compared to at older ages and with higher incomes (due to labour-force participation patterns). The pension system, private or public, cannot be faulted for not providing significant employment pensions to those who do not make a career of reasonable length in the labour force.'

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